Attachment 1

United States Government Accountability Office

GAO

Report to Congressional Requesters

May 2005

DOD EXCESS PROPERTY

Management Control Breakdowns Result in Substantial Waste and Inefficiency

GAO-05-277

Objectives, Scope, and Methodology

The purpose of our audit was to assess the economy and efficiency of the Department of Defense (DOD) excess property program. In doing so, we assessed the effectiveness of systems, processes, and controls for assuring a strong reutilization program. Where we found controls to be ineffective, we tested them further to determine (1) the magnitude and (2) root causes of associated waste and inefficiency. Our audit and investigation focused on Defense Logistics Agency (DLA) purchases of consumable items and Defense Reutilization and Marketing Service (DRMS)[1] excess property inventory activity during fiscal years 2002 and 2003, the most current fiscal years for which data were available at the time we initiated our audit. To illustrate continuing problems, we obtained excess DOD commodity items in new, unused, and excellent condition (A condition) during fiscal year 2004 and the first quarter of fiscal year 2005 that were in use by the military services, were being purchased by DLA, or both at the time they were available for reutilization.

We obtained access to the following systems and databases to support our audit and investigation.

- The DRMS Automated Information System (DAISY), which is an automated inventory accounting management data system designed to process excess DOD property from receipt to final disposal.
- The DRMS Management Information Distribution and Access System (MIDAS), which contains historical (archive) DAISY information.
- DLA's DOD Activity Address Directory (DODAAD), which contains information to identify agency names and addresses for activity codes that are associated with excess property requisitions.
- The Government Liquidation, LLC[2] database, which contains transactions on public sales of excess DOD property items.
- DLA's Standard Automated Materiel Management System (SAMMS), which contains transaction data on purchases by commodity group.

[1] DRMS is responsible for the disposal of excess property received from the military services and other DOD agencies.

[2] Government Liquidation, LLC is the DRMS commercial venture partner (contractor) for public sales of excess DOD property.

- The Federal Logistics Information System (FEDLOG), which is a logistics information system managed by the Defense Logistics Information Service (DLIS)[3] within DLA. This system contains detailed information on specifications, use, acquisition cost, and sources of supply for national stock numbered items, including more than 7 million stock numbers and more than 12 million part numbers.

We obtained online access to DAISY, MIDAS, DODAAD, and FEDLOG, and we obtained copies of the SAMMS databases for fiscal years 2002 and 2003 and Government Liquidation, LLC databases for June 2001 through December 2004. For each of the DOD systems and databases used in our work, we (1) obtained information from the system owner/manager on their data reliability procedures; (2) reviewed systems documentation; (3) reviewed related DOD Inspector General reports, DLA Comptroller budget data, and independent public accounting firm reports related to these data; and (4) performed electronic testing of commodity purchase and excess inventory databases to identify obvious errors in accuracy and completeness. We verified database control totals, where appropriate. We also received FEDLOG training from the DLIS service provider. When we found obvious discrepancies, such as omitted national stock number (NSN)[4] data in the DLA commodity purchases databases and transaction condition coding errors in the DRMS excess property systems data, we brought them to the attention of agency management for corrective action. We made appropriate adjustments to transaction data used in our analysis, and we disclosed data limitations with respect to condition coding errors and the omission of NSN data that affected our analysis. Our data analysis covered commodity purchases and excess commodity turn-ins and disposal activity during fiscal years 2002 and 2003. In addition, we statistically tested the accuracy of excess inventory transactions at five Defense Reutilization and Marketing Offices (DRMO) and five DLA supply depots. We also reviewed summary data and selected reports on DRMS compliance reviews of 91 DRMOs during fiscal year 2004 to determine the extent to which DRMS had identified problems with adherence to DOD and

[3] DLIS manages the Federal Catalog System, which includes nearly 7 million active supply items and operates the Federal Logistics Information System, which contains information on national stock numbers, part numbers, prices, packaging and shipping, and disposal instructions.

[4] An NSN is a 13-digit number that identifies standard use inventory items. The first 4 digits of the NSN represent the Federal Supply Classification, such as 8430 for men's footwear, followed by a 2-digit NATO code and a 7-digit designation for a specific type of boot, such as cold weather boot.

DRMS policies, made recommendations for corrective actions, and monitored DRMO actions to address its recommendations. Based on these procedures, we are confident that that the DOD data were sufficiently reliable for the purposes of our analysis and findings.

Magnitude of Excess Property Reutilization Program Waste and Inefficiency

To determine the overall magnitude of waste and inefficiency related to the DOD excess property reutilization program, we identified fiscal year 2002 and 2003 excess commodity disposal activity by property condition code and examined the extent of DOD reutilization of excess items in new, unused, and excellent condition (A-condition) versus transfers, donations, public sales, and other disposals outside of DOD through scrap, demilitarization, and hazardous materials contractors. We also compared DLA commodity purchase transactions to identical excess new, unused, and excellent condition items to identify instances where DLA purchased commodity items rather than reutilizing these excess items. We used NSN data as the basis for identifying identical items. In addition, we analyzed DLA supply depot excess commodity turn-ins to determine the extent to which new, unused DLA supply depot inventory accounted for turn-ins of excess of A-condition items. We used IDEA audit software[5] to facilitate our analysis.

Analysis of the Extent of DOD Reutilization

To determine the extent to which DOD reutilized excess commodities in A condition during fiscal years 2002 and 2003, we used online access to the DRMS MIDAS database of historical transactions and performed data mining[6] and analysis of the universe of excess commodity turn-in and disposal transactions. We identified key data elements, such as disposal transaction types, the excess property recipient DOD Activity Address Code (DODAAC), and condition codes. We used these data elements to identify the extent of DOD reutilization of excess A-condition commodities compared to transfers; donations; public sales; and disposals of scrap, hazardous materials, and demilitarized items. We determined the type of disposal transaction through analysis of the DODAAC that identifies the

[5] Interactive Data Extraction and Analysis software developed by CaseWare International, Inc., and distributed by Audimation, Inc., Houston, Texas, CaseWare's U.S. business partner.

[6] Data mining involved queries of DLA's commodity purchase databases and DRMS excess inventory system to identify patterns of activity, such as turn-ins and disposals of A-condition excess commodities; reutilization, transfers, donations, sales, and destruction of excess items; and items that were being purchased when identical new, unused, and excellent condition items were available for reutilization.

name and address of the agency or program that received (or requisitioned) the property. Because DOD considers special program[7] reutilization the same as DOD reutilization, we used DODAACs to separately identify reutilization transactions for special programs that were not directly associated with DOD activities. We also used DODAAC information to determine the identity of turn-in generators and requisitioners of excess DOD commodities for subsequent interviews of generators regarding why new, unused items were excessed and excess property users about their experience.

Analysis of Other Types of Excess Property Disposals

We also worked with DRMS officials to obtain information on transaction codes for identifying disposals of hazardous materials, scrap, and demilitarized items. We independently performed data mining and analysis, and we verified the results of our queries with DRMS officials in order to provide reasonable assurance that our data-mining approach and results were accurate. We used the Government Liquidation, LLC database to determine the acquisition value of commodity items sold and sale revenues during fiscal years 2002 and 2003.

Analysis of Commodity Purchases Transactions

We used the six SAMMS commodity purchases databases we obtained to identify key information on commodity items that military units purchased from DLA, including the item description or name, NSN, purchase date, unit price, unit acquisition cost, and full cost including the DLA user fee. The six commodity groups we audited included (1) construction and land and maritime weapons, (2) electrical, (3) general, (4) industrial, (5) medical, and (6) textile. We worked with DLA officials to identify items to a commodity group based on the supply class number included in the NSN or local stock number (LSN).[8]

To determine the extent to which DLA made unnecessary purchases of new items when identical items that were reported to be in A condition were available for reutilization, we compared commodity purchase transactions in SAMMS to excess property turn-in transactions in MIDAS. We used NSNs to identify instances where the military services ordered and

[7] Special programs, such as the Humanitarian Assistance Program and law enforcement agencies, are listed and described in app. IV.

[8] An LSN consists of the four-digit federal supply classification number, a two-digit NATO code, and up to a seven-character description, such as "monitor" for a computer monitor and "boots" for cold weather boots.

purchased items from DLA at the same time identical items that were reported to be in new or excellent condition were available for reutilization. Although we identified at least $400 million in fiscal year 2002 and 2003 wasteful purchases related to A-condition excess items that were available for reutilization, we were unable to determine the full magnitude of this problem due to inconsistent recording of NSNs and improper downgrading of condition codes.

Case Study Examples

We performed case study investigations of excess commodity turn-ins and disposals during fiscal years 2002 through 2003. In addition, to illustrate that DRMS reutilization program waste and inefficiency are continuing problems, during fiscal year 2004 and the first quarter of fiscal year 2005, we obtained several excess DOD commodity items that were currently in use, were being purchased at the time we acquired them, or both. We used data mining and analysis to identify commodity items for our case study acquisitions. To identify new and unused excess DOD commodity items that were available for requisition at no cost, we accessed the DRMS Reutilization, Transfer, and Donation Web page and identified excess DOD commodity items available to federal agencies. We confirmed that these items were available to federal agencies by also accessing the General Services Administration's (GSA) GSAXcess Web page. We used GAO's federal agency DODAAC to requisition new and unused excess DOD commodity items in A condition. We submitted our requisitions for transfer of these excess DOD items through GSA. To identify new and unused items that we could purchase at minimal cost, we accessed govliquidation.com. We also accessed govliquidation.com to identify continuing sales of our case study items.

We based our case study selections on commodities used by military units and the quantity and dollar amount of purchases and excess property turn-ins associated with these items. After we identified each new and unused case study item that we wanted to purchase, we queried FEDLOG to confirm the acquisition cost and current use of the item—that is, whether an item was still being purchased or currently in use but being phased out or was obsolete. For further assurance on the status of the excess commodities that we targeted for acquisition, we contacted the DLA item managers responsible for these items to confirm that they were currently being purchased, were in use by the military services, or both. We also contacted item managers to obtain information on how certain items, such as circuit cards and power supply units, were used.

Causes of Reutilization Program Waste and Inefficiency

To determine the root causes of identified inefficiencies, we first gained an understanding of the processes for acquisition and disposal of DOD commodities. We reviewed applicable laws and regulations and DOD, military service, DLA, and DRMS policies and procedures. We also reviewed the DRMS contracts for DRMO property warehouse services and liquidation sales for consistency with DOD policies. In addition, we reviewed SAMMS and MIDAS system manuals. We met with and contacted numerous DLA and DRMS officials and obtained documentation to assess how the property reutilization program is monitored for effectiveness. We also met with or contacted DOD and Army, Navy, and Air Force officials about their experience with commodity acquisitions, reutilization, and disposals. We interviewed DLA item managers and buyers to obtain information on their roles and responsibilities and key systems and controls involved in the commodity acquisition and management process. We also obtained information on how decisions are made about whether to purchase new items or to reutilize excess items through DOD's reutilization program. We made visits to 12 DRMOs to observe excess property processing, screen for excess case study items, investigate the disposition of excess property turn-ins, or test the accuracy of excess property inventory. We also visited five DLA-managed Defense depots to test inventory accuracy and observe excess property disposal processes. In addition, we visited 10 Government Liquidation, LLC sales locations.

We focused our assessment of the causes of reutilization program waste and inefficiency on key aspects of the overall management control environment, including (1) data reliability, (2) physical inventory control, and (3) the current systems environment. We used GAO's *Standards for Internal Control in the Federal Government*[9] as criteria for identifying internal control breakdowns that contributed to waste and inefficiency.

[9] GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999). This document was prepared to fulfill GAO's statutory requirement under 31 U.S.C. § 3512 (c), (d), commonly known as the Federal Managers' Financial Integrity Act of 1982, to issue standards that provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

Data Reliability

We statistically tested[10] the accuracy of current excess commodity inventory transaction data at five DRMO warehouse locations and five DLA supply depot locations. Each location was a separate population of randomly selected transactions. We randomly selected transactions from the population of current inventory transactions at each of the test locations. The five DRMO locations we tested were the Columbus DRMO in Ohio; the Stockton DRMO in French Camp, California; the Hill DRMO at Hill Air Force Base in Ogden, Utah; and the Norfolk DRMO and the Richmond DRMO in Virginia. Our selection of the five DRMOs was based on geographic location, turn-in volume, types of excess items handled, and military units generating the most turn-ins. We tested inventory at Defense depots that were co-located or located within proximity of the above DRMOs, including Defense depots at Columbus, Ohio; San Joaquin, California; Hill Air Force Base, Utah; Norfolk, Virginia; and Richmond, Virginia. Each location was a separate population, and we evaluated the results of each sample location separately.

The purpose of our testing was to evaluate the effectiveness of controls over existence—including timely recording of transactions, item description (item name and NSN), and quantity—and condition coding. Appendix V describes the specific criteria we used to conclude on the effectiveness of DRMO and DLA supply depot controls for inventory accuracy.

Physical Inventory Control

Our assessment of physical inventory control focused on the results of our statistical tests discussed above and our review of DRMS summary data on reported DRMO and DLA supply depot losses due to lost, stolen, and damaged property. We investigated problems associated with liquidation contractor controls for safeguarding excess DOD property held for sale at the Huntsville, Alabama, and the Norfolk, Virginia, sales locations. We also assessed the extent of damage to our case study purchase of bandages and medical supply items from the Norfolk sales location. In addition, we obtained DRMS summary reports on losses of excess property at DRMOs and DLA supply depots for fiscal years 2002 through 2004. We referred locations with the largest reported losses to our Office of Special Investigations for further investigation.

[10] Our statistical tests were based on a random sample of the population of excess inventory transactions at each test location, which permitted us to estimate, or project, the errors in the population at each location.

Commodity Inventory Systems Environment

To gain an understanding of DLA commodity purchase and DRMS commodity inventory systems and processes with regard to DOD's excess property reutilization program, we reviewed DLA and DRMS policies and procedures, and interviewed DLA, DRMS, and DRMO program and systems officials. We also used observations and information obtained during our statistical tests, excess property screening visits, and case study investigations. In addition, we relied on the body of work GAO has performed in this area.[11]

To determine the scope and status of DLA and DRMS systems efforts to improve the reutilization process in the future, we interviewed DLA and DRMS systems officials who are responsible for DLA's Business Systems Modernization (BSM) and Integrated Data Environment (IDE) and the DRMS Reutilization Modernization Program (RMP).[12] We also reviewed business systems modernization plans and related documents to determine the current status, implementation time frames, and scope of planned improvements. In addition, we obtained and reviewed the *Reutilization Management Program Functional Requirements Document*, the RMP *Decision Matrix*, and implementation timelines. We focused our assessment on whether the systems modernization efforts, as currently documented, would adequately address needed improvements in excess property reutilization program economy and efficiency.

We conducted our work from November 2003 through February 2005 in accordance with U.S. generally accepted government auditing standards. We performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

[11] GAO, *DOD Management: Examples of Inefficient and Ineffective Business Processes*, GAO-02-873T (Washington, D.C.: June 25, 2002), and *DOD Business Systems Modernization: Billions Continue to Be Invested with Inadequate Management Oversight and Accountability*, GAO-04-615 (Washington, D.C.: May 27, 2004).

[12] BSM is intended to replace DLA's SAMMS, and IDE may be selected to provide a means of interfacing with, or sharing information between, DLA systems. RMP is the planned upgrade for DRMS's DAISY and MIDAS.

Comments from the Department of Defense

DEPUTY UNDER SECRETARY OF DEFENSE FOR
LOGISTICS AND MATERIEL READINESS
3500 DEFENSE PENTAGON
WASHINGTON, DC 20301-3500

April 15, 2005

Mr. Gregory D. Kutz
Director, Financial Management and Assurance
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Kutz:

This is the Department of Defense (DoD) response to the GAO draft report, "DOD EXCESS PROPERTY: Management Control Breakdowns Result in Substantial Waste and Inefficiency," dated March 10, 2005 (GAO Code 192105/GAO-05-277).

The report recommends that the Secretary of Defense direct the Director of the Defense Logistics Agency (DLA); the Commander of the Defense Reutilization and Marketing Service; and the Secretaries of the Army, the Navy, and the Air Force, as appropriate, to take 13 actions to improve DoD's excess property reutilization program.

The Department concurs that action is needed to improve the reutilization process. Specific responses to each of the 13 recommendations are detailed in the enclosure. The DoD appreciates the opportunity to comments on the draft report.

Sincerely,

Bradley Berkson
Acting

Enclosure:
As stated

GAO CODE 192105/GAO-05-277
"DOD EXCESS PROPERTY: MANAGEMENT CONTROL BREAKDOWNS RESULT IN SUBSTANTIAL WASTE AND INEFFICIENCY"

DEPARTMENT OF DEFENSE COMMENTS TO THE RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense direct the Director of the Defense Logistics Agency (DLA) direct Defense Reutilization and Marketing Service (DRMS) to clarify and enforce the policy that permits the Defense Reutilization and Marketing Office (DRMO) management to waive the requirement to verify quantities on turn-ins under exempted conditions, and consider additional criteria for maintaining accountability of military equipment items. (p. 45/GAO Draft Report)

DoD RESPONSE: Concur. DRMS will review the guidance found at DoD 4160.21-M, Chapter 2, Section E (1)(d) and DRMS-I 4160.14, Vol. II, Chapter 2, Section 1(B)(6)(c), and clarify those situations where DRMS personnel are allowed to waive the quantity verification requirement. DRMS will also ensure its employees understand this guidance and DoD policy, and consider additional criteria to maintain appropriate property accountability through continuous education. In March 2004, DRMS initiated a risk assessment program to evaluate certain DRMS processes and develop appropriate risk mitigation strategies. DRMS will utilize this program in reviewing applicable segments of the receiving process to validate past practices and consider potential changes in light of further perceived risk.

Further, DRMS reviews property accountability as part of its internal Compliance Program (self assessment and organizationally independent compliance inspections), and will review its current audit protocols to ensure that accurate counting of items at receipt is a part of its Compliance Assessments. Result of this assessment will be available in November 2005.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense direct the Director of the Defense Logistics Agency to require DRMS to identify DRMOs with insufficient human capital resources and take appropriate action to assure that excess property receipts are verified and processed in an accurate and timely manner. (p. 45/GAO Draft Report)

DoD RESPONSE: Partially concur. DRMS will use its staffing model to determine the staffing needs by receipt workload and adequately staff its DRMOs to ensure excess property receipts are verified and processed in accordance with appropriate policies. However, other management actions are also being considered to address this issue. For example, DRMS is currently using contract hires at its DRMOs, rather than hiring new Government employees, because DRMS is in the final stages of an OMB Circular A-76 competition for the receipt, storage, and issue functions of useable property at all of its CONUS DRMOs. This competition is to be completed later this year. Results of this assessment will be available in November 2005.

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RECOMMENDATION 3: The GAO recommended that the Secretary of Defense require the Director of the Defense Logistics Agency to develop a mechanism for linking prime vendor purchase transactions to National Stock Numbers (NSN) or other unique product identification. (p. 45/GAO Draft Report)

DoD RESPONSE: Partially Concur. DoD Directives require generators to provide a description of the item on the turn-in document when it is turned in to a DRMO under a Local Stock Number (LSN). DLA's Prime Vendor purchases provide commercial, non-stocked items to military customers direct from vendors. These items are consumable, meaning they are intended for immediate use by the military customer. Bringing these items back into depot stock would negate warehousing/distribution savings achieved as a result of relying on the commercial supply chain. The increased technical documentation requirements required to assign national stock numbers to these non-stocked, commercial items will drive up costs significantly. Also, requiring Prime Vendors to convert commercial marking systems to military systems would run counter to the 1994 Federal Acquisition Streamlining Act preference to buy commercial.

RECOMMENDATION 4: The GAO recommended that the Secretary of Defense direct the Director of the Defense Logistics Agency to direct DRMS to develop written guidance and formal training to assist DRMO personnel and Military Service turn-in generators in the proper assignment of condition codes to excess property turn-ins. (p. 46/GAO Draft Report)

DoD RESPONSE: Partially Concur. The generating activities are responsible for the assignment of supply condition codes (SCC). The Military Services generating these excess materials are in the better position to assign SCCs and understand the impacts of the factors like functional obsolescence, material aging, and previous storage and handling situations. Generators from each of the Services currently receive formal blocks of instruction, as well as appropriate on-the-job training, on specific disposal procedures as part of their logistics education.

The DRMS provides guidance and training material to DRMS personnel, the Military Services and Defense Agencies regarding condition codes, including the web-based information and guidance found on the DRMS Web Site. It provides a DoD Disposal Manual, DoD 4160.21-M, and guidance found in the DRMS-Instruction 4160.14. Additional efforts are being undertaken to highlight supply condition codes issues in training and web based resources. Additionally, DRMS will review current guidance and coordinate with Headquarters, Defense Logistics Agencies and the Military Services to ensure the appropriate assignment of responsibilities regarding the establishment and use of supply condition codes. Results of this assessment will be available in November 2005.

RECOMMENDATION 5: The GAO recommended that the Secretary of Defense direct the Secretaries of the Army, Navy and Air Force to direct the military services to provide accurate excess property turn-in documentation to DRMS, including proper assignment of condition codes and NSNs based on available guidance. (p. 46/GAO Draft Report)

DoD RESPONSE: Concur with intent. Existing Military Service policies and procedures require all generators to file accurate property turn-in documentation, as defined by DRMS, and the Services recognize the importance and ramifications of assigning accurate supply condition codes and National Stock Numbers (NSNs) to all property turned-in to DRMS facilities. However, the Services have agreed to reexamine their current procedures to determine if they are adequately implementing those policies and procedures.

Service policy is to reuse materiel to the fullest extent possible regardless of the category of the supply item, while considering economy and safety. Generators of excess and surplus property are required to identify the condition of items excess to their needs prior to disposal through DRMO or return to the supply system. If the condition cannot be determined, certified supply inspectors assist in this process. Service personnel have taken steps to consult with supply personnel to ensure a basic understanding of the updated military instructions. All of the Services endeavor to provide required information to applicable turn-in activities electronically, per the instruction found in the disposal directives.

Current Military Service procedures allow the repair of all spare parts and equipment when economically feasible. When repair actions are necessary, the custodian will properly identify the condition of the item on DD Form 1577-2 and attach the tag to the item. When the custodian is not sure of the condition of the item, another qualified maintenance technician or inspector will be asked to help determine the condition of the materiel. Condemned equipment items, beyond economical repair, require the signature of a qualified maintenance technician on DD Form 1577 or the repair cost estimate from the repair center. Either of these actions must take place before the turn-in process can be accomplished.

Not all DoD items have assigned NSNs, as indicated in our response to recommendation 3 above. However, as a minimum, all transfers to DRMO for non-NSN items are required to have a description of the materiel attached to or annotated on the disposal document.

We will direct the Services and DLA to assess their training in condition codes and accuracy of property turn-in documentation. Results of this assessment will be available in November 2005.

RECOMMENDATION 6: The GAO recommended that the Secretary of Defense direct the Secretaries of the Army, Navy and Air Force to require the Military Services to establish appropriate accountability mechanisms, including supervision and monitoring, for assuring reliability of turn-in documents. (p. 46/GAO Draft Report)

DoD RESPONSE: Concur. The Services recognize that accountability, supervision, and monitoring are imperative to all logistics operations. The Services and DLA already have systems in place to capture the required data. At the wholesale level, we support this recommendation to establish appropriate accountability mechanisms, including supervision and monitoring, to assure reliability of turn-in documents. DOD policy for retail and wholesale supply requires customers to return excess serviceable or unserviceable materiel to the Service supply activity or appropriate maintenance activity or comply with appropriate disposition instructions. The Services monitor these activities and work with DRMS to ensure visibility of assets throughout the disposal process to ensure a closed loop with regard to transaction item reporting among all Services and Defense Agencies involved. We will direct the Services and DLA to assess the adequacy of their existing systems to capture reliable turn-in data and to generate exceptions reports. Results of this assessment will be available in November 2005.

RECOMMENDATION 7: The GAO recommended that the Secretary of Defense direct the Director of the Defense Logistics Agency and DRMS to review DLA supply depot and DRMO excess property loss reports to identify systemic weaknesses and take immediate and appropriate corrective actions to resolve them. (P. 46/GAO Draft Report)

DoD RESPONSE: Concur. The Agency agrees with the importance of being able to identify and correct systemic weaknesses in property loss reporting. DLA, the Supply Depots and DRMS are already implementing actions to improve our ability to detect actual losses, determine their causes, and take future action to mitigate such risks.

DRMS issued interim guidance to its personnel affecting how losses and adjustments are reported in the DRMS Automated Information System (DAISY). The purpose of this guidance is to improve reason code accuracy and to be able to distinguish "bookkeeping adjustments" from actual physical losses of property.

In February 2005, DRMS issued a task order to the Defense Logistics Agency Office of Operations Research and Resource Analysis (DORRA) to study systemic weakness in DRMS property accounting, provide an assessment of what percentage of losses are attributable to actual physical losses of property rather than record keeping errors, and examine DRMS' records to determine the exact nature of these reported inventory adjustments. Preliminary findings indicate that approximately 67% of the "H" coded losses represent inventory adjustments and data errors rather than a true loss of inventory. Thus, as noted, many of the "losses" cited result from record adjustments and do not reflect actual losses of property indicative of security or property management lapses.

The Defense Distribution Center (DDC) has a long standing program called the "SWARM" Inventory Improvement Initiative. SWARM is a wide-ranging, site-by-site program designed to: 1) identify the root cause of balance errors; 2) train employees on a case-by-case basis; 3) hold all employees accountable for their process; 4) provide comprehensive formal training on policy, processes and systems and clean up the physical warehouse location balances; and 5) Correct the accountable transaction records.

The SWARM is reported to the DLA Director monthly and has already made significant progress in achieving its goals. Our goal is to meet the MILSTRAP performance standards, and the Military Services' expectations of accuracy. Results of this assessment will be available in November 2005.

RECOMMENDATION 8: The GAO recommended that the Secretary of Defense direct the Director of the Defense Logistics Agency to direct DRMS to take immediate, appropriate action to resolve identified uncorrected DRMO security weaknesses. (p. 46/GAO Draft Report)

DoD RESPONSE: Concur. DRMS policy is to take immediate appropriate action to resolve identified security weaknesses. DRMS has done so with respect to previous situations that have come to its attention and has done or will do so with respect to issues raised in the draft Report. Results of this assessment will be available in November 2005.

RECOMMENDATION 9: The GAO recommended that the Secretary of Defense direct the Director of the Defense Logistics Agency to require DRMS to determine the monthly sales volume of excess property at the DLA supply depots and work with its liquidation sales contractor to identify the appropriate number and liquidation sales locations needed to handle the sales of excess DLA depot property. In making these determinations, DRMS and its contractor should consider whether contractor staffing and warehouse capacity at each location are adequate to handle the volume of property shipped to those locations for sale. (p. 46/GAO Draft Report)

DoD RESPONSE: Concur. The DLA supply depots provide DRMS a weekly property list detailing the amount and type of excess and surplus personal property to be disposed of through Reutilization, Transfer, Donation and Sales. From this information, DRMS develops a property list that will be delivered to the liquidation sales contractor after statutorily mandated screening is completed. The Agency has implemented system changes to provide the property list 42 days in advance of delivery to the contractor.

The DRMS and its sales contractor also review past monthly historical shipments of property. From this information, both the liquidation contractor and DRMS can determine whether current storage capacities and staffing are adequate. The review will conclude whether additional sites should be added or different shipping routes be considered on a one-time basis. This review process is ongoing. DRMS, in conjunction with its liquidation contractor, directs surge or "overflow" quantities of excess property to alternate sites. Additional agency personnel have been assigned to specifically help process property shipped from the supply depots. The liquidation contractor also improved the management team responsible for handling depot property. The results of any changes undertaken will also be reviewed and modifications implemented as appropriate. Results of this assessment will be available in November 2005.

RECOMMENDATION 10: The GAO recommended that the Secretary of Defense direct the Director of the Defense Logistics Agency to require DRMS to periodically inspect liquidation contractor facilities and take immediate action to correct structural impairments and other deficiencies, such as outside storage due to inadequate warehouse capacity that could result in damage of excess DOD property held for sale. (p. 46/GAO Draft Report)

DoD RESPONSE: Partially Concur. Inspection of all liquidation contractor facilities has been completed and periodic inspections will continue. The only facility requiring immediate structural repair is the Norfolk facility. DRMS has issued a work order to fix minor structural issues. Actions are being taken to ensure property damage does not occur, which may include diverting property to other sites, if required. Additional storage options are being regularly evaluated by the contractor and DRMS. Facility condition and protection of stock is a key issue for DRMS and Government Liquidation (GL) as the contract provisions provide for increased revenue for both parties based on the selling price of the item. Results of this assessment will be available in November 2005.

RECOMMENDATION 11: The GAO recommended that the Secretary of Defense direct the Director of the Defense Logistics Agency to direct DRMS to consider available options and implement an interim process for identifying turn-ins of excess new, unused, and excellent condition items that could be reutilized to avoid unnecessary purchases in the existing systems environment. (p. 46/GAO Draft Report)

DoD RESPONSE: Partially Concur. Actions have already been taken to respond to this recommendation. Since 2004, DRMS implemented several initiatives to improve the visibility of disposal assets to DOD. These initiatives include the deployment of Pre-receipt Want Lists, Automated Want List Match against current inventory, and expedited processing property visibility on the DRMS website. In February 2005, DRMS deployed a new web application that allows DOD customers to ask questions on-line about property in inventory, including the ability to request pictures of the item if the condition code is in question. Answers are added to the property description and are available for all customers to view.

In addition, DRMS will work with the Item Managers on the best methodology to provide visibility of "A" condition property. Listings can be tailored for each Item Manager to include only those items or commodities (Federal Stock Class (FSC) or NSN specific) for which they are responsible. Results of this assessment will be available in January 2006.

RECOMMENDATION 12: The GAO recommended that the Secretary of Defense direct the Director of the Defense Logistics Agency to direct DLA Business Systems Modernization (BSM) and DRMS Reutilization Modernization Program (RMP) systems officials to coordinate on the identification of key data elements for identifying excess property that should be reutilized before completing the design of functional requirements for reutilization of excess commodities for BSM and RMP. (p. 46/GAO Draft Report)

DoD RESPONSE: Concur. Reutilization of DRMS assets is part of the Release 2.2 functionality of DLA's BSM program scheduled for implementation in January 2006. DLA and DRMS developed an interface between the DAISY and BSM for A1 condition code (new, unused and excellent) to provide property visibility and to allow for asset recoupment. BSM Release 2.2 functionality seeks maximum use of DRMS excess material categorized as A1 condition. The Release 2.2 functionality will search DRMS records daily for assets in A1 condition, and if found, will systematically initiate action to recoup those assets in accordance with the items economic retention limits. The system (BSM) will automatically process this information against identified supply needs to locate matching property. When an item is identified, DLA's BSM initiative will generate a requisition request for the item to return it to DLA stock. The interface is in the build phase and testing is scheduled for June through December 2005. Implementation is scheduled for BSM Release 2.2 in January 2006. Additionally, DRMS will further integrate asset recoupment processes in the DRMS RMP.

The "Gap Analysis" process for the DRMS RMP is underway with the BSM application as a primary "target" for functionality requirements. Our initial update on the GAP Analysis will be provided in November 2005. Full Operational Capability (FOC) for the DRMS RMP will be realized in FY 2009.

RECOMMENDATION 13: The GAO recommended that the Secretary of Defense direct the Director of the Defense Logistics Agency to require that DLA's BSM system design include edit controls that would reject a purchase transaction or generate an exception report when A-condition excess items are available but are not selected for reutilization at the time that purchases are made. (p. 47/GAO Draft Report)

RESPONSE: Concur. BSM's Release 2.2 functionality seeks maximum use of DRMS excess categorized as A1 condition. The Release 2.2 functionality will search DRMS records daily for assets in A1 condition, and if found, will systemically initiate action to recoup those assets in accordance with the items' economic retention limits. By proactively seeking to identify and recoup assets based on economic limits, the DLA will ensure maximum utilization of assets at the DRMS and will preclude the need to procure items when excess assets are available to be reutilized. Results of this assessment will be available in March 2006.

7

Excess Property Condition Codes

DOD's condition code is a two-digit alphanumeric code used to denote the condition of excess property from the supply and the disposal perspective. The DOD supply condition code is the alpha character in the first position and shows the condition of property in the DLA depot inventory, or is assigned by the unit turning in the excess property. The GSA disposal condition code, in the second position, shows whether the property is in new, used, or repairable condition, salvageable, or should be scrapped. (See table 7.)

Table 7: DOD Excess Property Condition Codes

DOD codes	DOD supply condition code	GSA disposal condition code
	Serviceable property	
A1, A4	**A – Issuable without qualification** – New, used, repaired or reconditioned property that is issuable without restriction, including material with a shelf life of more than 6 months.	**1 – Excellent** – Property is in new or unused condition and can be used immediately without repairs.
B1, B4	**B - Issuable with qualification** – New, used, repaired, or reconditioned property that is issuable, but is restricted from issue to specific units, activities, or geographical areas by reason of its limited usefulness or short service life expectancy, including materials with a shelf life of 3 through 6 months.	**4 – Usable** – Property shows some wear, but can be used without significant repair. **7 – Repairable** – Property is unusable in its current condition, but can be economically repaired.
C1, C4	**C - Priority issue** – Property is issuable to selected customers but must be issued before Condition A and B material to avoid loss as a usable asset, including materials with less than 3-months' shelf life.	
D1, D4, D7	**D - Test/Modification required** – Property is in serviceable condition but requires test, alteration, modification, or conversion or disassembly.	
	Unserviceable property	
E7	**E - Limited restoration required** – Property requires only a limited expense or effort to restore to serviceable condition.	**7 – Repairable** – Property is unusable in its current condition, but can be economically repaired.
F7	**F – Reparable** – Property is economically reparable but requires repairs, overhaul, or reconditioning to make it serviceable property.	
G7	**G – Incomplete** – Property requires additional parts or materials to complete the item prior to issue.	
H7	**H - Condemned** – Property has been determined to be unserviceable and does not meet repair criteria, including items whose shelf life has expired and cannot be extended.	

(Continued From Previous Page)

DOD codes	DOD supply condition code	GSA disposal condition code
	Salvage property	
FX, GX, HX (**VX-** Salvaged military munitions)	**F – Reparable; G – Incomplete; H – Condemned**	**X - Salvage** – Property has value in excess of its basic material content, but repair is impractical and/or uneconomical.
	Scrap property	
FS, GS, HS	**F – Reparable; G – Incomplete; H – Condemned**	**S - Scrap** – Property has no value except for its basic material content.

Source: DAISY C-A-T (Codes and Terms) reference guide (11th ed. 2003) and DRMS-I 4160.14, vol. IV, Supp. 1, "Codes Index" (November 2004).

Programs Authorized to Receive Excess DOD Property

Table 8 lists the DOD special programs that are authorized to receive excess property. In addition to DOD special programs, under the Stevenson-Wydler Technology Innovation Act of 1980, as amended,[1] DOD makes computer equipment available to schools under the federal government's Computers for Learning Program following the DOD and special program screening period and prior to the federal agency screening period. In accordance with 15 U.S.C. § 3710(i), the director of a laboratory or the head of any federal agency or department may loan, lease, or give research equipment that is excess to the needs of the laboratory, agency, or department to an educational institution or nonprofit organization for the conduct of technical and scientific education and research activities.

Table 8: DOD Special Programs

Humanitarian Assistance Program (HAP)	10 U.S.C. § 2557 authorizes the Secretary of Defense to make available nonlethal excess DOD supply items for humanitarian relief purposes, and 10 U.S.C. § 2561 authorizes the Secretary of Defense to use DOD's Humanitarian Assistance appropriations to transport supply items to needy countries.
Law enforcement agencies (LEA)	10 U.S.C. § 2576a authorizes the Secretary of Defense to transfer excess DOD property that is suitable for use by LEAs to federal and state agencies, including counter-drug and counter-terrorism activities. Recipients pay for transporting the property.
Museums	10 U.S.C. § 2572 authorizes the Secretary of Defense to loan, gift, or exchange documents, historical artifacts, and condemned or obsolete combat materiel to a municipal corporation, county, or other political subdivision of a state; a servicemen's monument association; a museum, historical society, or historical institution of a state or foreign nation or nonprofit military aviation heritage foundation or association; or a post of the Veterans of Foreign Wars of the United States, the American Legion, or other recognized war veterans' association.
National Guard units	National Guard units are designated by DOD to receive excess DOD property with the approval of the National Guard Bureau or the U.S. Property and Fiscal Officer, or their authorized representative, for the state in which the National Guard unit is located.
Senior Reserve Officer Training Corps units (ROTC)	ROTC units are designated by DOD to receive excess DOD property to support supplemental proficiency training programs with approval of the cognizant installation commander or designee. Junior ROTC units are not covered.
Morale, welfare, and recreation activities and services (MWR)	MWR activities are authorized by DOD to receive excess DOD property through their servicing accountable officer.
Military Affiliate Radio System (MARS)	MARS operates under the command jurisdiction of the military services and is an integral part of the DOD communications system. DOD has authorized the military services to requisition excess DOD property from DRMOs.

[1] Pub. L. No. 96-480, 94 Stat. 2311 (Oct. 21, 1980), as amended (15 U.S.C. § 3701, et seq.); Computers for Learning Program established under the act's authority; and Exec. Order No. 12,999, 61 *Fed. Reg.* 17,227 (Apr. 19, 1996).

(Continued From Previous Page)	
Civil Air Patrol (CAP)	As the official auxiliary of the U.S. Air Force, CAP is eligible to receive excess DOD property. Title to the property is transferred to CAP upon the condition that it be used to support valid Air Force mission requirements.
DOD contractors	Military Standard Requisitioning and Issue Procedures (MILSTRIP) in DOD 4000.25-1M, *MILSTRIP Manual* (April 2004), provide for the military service or Defense agency management control activity to withdraw or authorize the withdrawal of specified excess property from a DRMO for use as government-furnished equipment to support officially stated contractual requirements.
Foreign governments and international organizations	Under the International Security Assistance and Arms Export Control Act of 1976 (Pub. L. No. 94-329, as amended, *codified at* 22 U.S.C. § 2751, et seq.), certain excess defense articles may be made available to eligible foreign countries and international organizations designated by the Department of State and DOD. Excess DOD property may also be available to eligible foreign countries and international organizations as foreign military sales under authority of the Foreign Assistance Act of 1961, as amended, codified at 22 U.S.C. § 2151, et seq.

Source: GAO analysis.

Results of Statistical Tests of Excess Commodity Inventory Accuracy

To evaluate the effectiveness of controls for assuring the accuracy of excess commodity inventory data, we tested current inventory transactions at five DRMO locations and five DLA supply depot locations. Our tests covered controls over physical existence, item description (item name and NSN), quantity, and condition code.[1] DRMO inventory locations tested were the Columbus DRMO in Columbus, Ohio; the Stockton DRMO in French Camp, California; the Hill DRMO at Hill Air Force Base, in Ogden, Utah; the Norfolk DRMO in Norfolk, Virginia; and the Richmond DRMO in Richmond, Virginia. For efficiency, we tested inventory at five DLA supply depots that were co-located or located within proximity of the above DRMOs, including the depots in Columbus, Ohio; San Joaquin County, California; Hill Air Force Base, Utah; Norfolk, Virginia; and Richmond, Virginia. Each location was a separate population, and we evaluated the results of each sample location separately.

We drew our statistical samples from the universe of excess property transactions in current DRMS DAISY inventory, which includes excess property warehoused at DRMOs and DLA supply depots. We stratified our samples by the two major categories of condition code—serviceable and unserviceable—in order to determine whether errors were more prevalent in one category. From the population of current excess DOD inventory at the time of our testing visit, we selected stratified random probability samples of excess property turn-in transactions for each of the five DRMO and each of the five DLA supply depot case study locations. With these statistically valid samples, each transaction in the population for the 10 case study locations had a nonzero probability of being included, and that probability could be computed for any transaction. Each sample transaction for a test location was subsequently weighted in our analysis to account statistically for all the transactions in the population for that location, including those that were not selected. Our test results relate to the populations of transactions at the respective DRMO and DLA supply depot locations, and the results cannot be projected to the population of excess property transactions or the DRMOs or DLA supply depots as a whole.

We present the results of our statistical samples for each population as (1) our projection of the estimated error overall and for each control attribute as point estimates and the two-sided 95 percent confidence intervals for the failure rates and (2) our assessments of the effectiveness

[1] A list of condition codes and definitions is included in app. III.

of the controls and the relevant lower and upper bounds of a one-sided 95 percent confidence interval for the failure rate. If the one-sided upper bound is 5 percent or less, then the control is considered effective. If the one-sided lower bound is greater than 5 percent, then the control is considered ineffective. Otherwise, we say that there is not enough evidence to assert either effectiveness or ineffectiveness. All percentages are rounded to the nearest percentage point.

Overall Results of Inventory Reliability Tests

Tables 9 and 10 present the overall results of our statistical tests of inventory accuracy at the five DRMOs and the five DLA supply depots that we tested. The overall results show that controls for assuring the accuracy of excess property inventory were ineffective at four of the five DRMOs and three of the five DLA supply depots that we tested. We tested physical existence, including whether turn-ins recorded in inventory could be physically located and whether inventory changes were recorded within 7 days. We also tested the accuracy of item descriptions (item name(s) and NSN(s)), recorded quantities, and condition code categories.

Table 9: DRMO Turn-in Transactions with One or More Control Test Failures

DRMO tested	Estimated failure rate (95 percent two-sided confidence interval)	Assessment of effectiveness of controls (and relevant bounds of 95 percent one-sided confidence intervals)
Richmond	25% (17% to 33%)	Ineffective Lower bound = 18%
Stockton	12% (7% to 18%)	Ineffective Lower bound = 8%
Hill	8% (4% to 14%)	Not enough evidence Lower bound = 5% or upper bound = 13%
Norfolk	18% (12% to 25%)	Ineffective Lower bound = 13%
Columbus	47% (37% to 56%)	Ineffective Lower bound = 39%

Source: GAO.

Note: Although some transactions included more than one type of error, we only counted one failure for a transaction.

Table 10: DLA Supply Depot Turn-in Transactions with One or More Control Test Failures

DLA depot tested	Estimated failure rate (95 percent two-sided confidence interval)	Assessment of effectiveness of controls (and relevant bounds of 95 percent one-sided confidence intervals)
Richmond	8% (4% to 13%)	Not enough evidence Lower bound = 5% or upper bound = 12%
San Joaquin	16% (11% to 23%)	Ineffective Lower bound = 12%
Hill	6% (3% to 10%)	Not enough evidence Lower bound = 3% or upper bound = 9%
Norfolk	14% (9% to 19%)	Ineffective Lower bound = 10%
Columbus[a]	12% (8% to 18%)	Ineffective Lower bound = 9%

Source: GAO.

[a]Most of the errors in our Columbus supply depot sample related to quantity errors for items such as machine screws, washers, and other small hardware items. Therefore, we did not consider these problems to be significant.

Because most of the errors we found related to the accuracy of condition codes, we separately estimated the error rates for this control attribute. A turn-in transaction was considered a failure if the serviceable or unserviceable condition code assigned to the item(s) was not accurate based on our physical observation and judgment. DLA and DRMO officials who accompanied us during our testing provided their perspectives, which we considered in our conclusions. We based our conclusions on obvious differences between the condition code assigned to the item and the appearance of the item. For example, some items were in the original manufacturer packaging and other items were obviously used, dirty, or worn. If we were unsure of the condition of an item, we accepted the condition code assigned by the military unit turn-in generator or the DLA supply depot. In addition, we did not question the assigned condition codes of technical equipment items such as electronic parts and scientific equipment. Tables 11 through 13 show the results of our condition code reliability tests for turn-in transactions at the five DRMOs that were coded as being in serviceable and unserviceable condition.

Table 11: DRMO Turn-in Transactions That Failed Overall Control Tests for Condition Code Accuracy

DRMO tested	Estimated failure rate (95 percent two-sided confidence interval)	Assessment of effectiveness of controls (and relevant bounds of 95 percent one-sided confidence intervals)
Richmond	22% (15% to 31%)	Ineffective Lower bound = 16%
Stockton	8% (4% to 13%)	Not enough evidence Lower bound = 5% or upper bound = 12%
Hill	5% (2% to 11%)	Not enough evidence Lower bound = 3% or upper bound = 10%
Norfolk	13% (8% to 19%)	Ineffective Lower bound = 9%
Columbus	22% (14% to 33%)	Ineffective Lower bound = 15%

Source: GAO.

Table 12: DRMO Turn-in Transactions Classified as Serviceable That Failed Control Tests for Condition Code Accuracy

DRMO tested	Estimated failure rate (95 percent two-sided confidence interval)	Assessment of effectiveness of controls (and relevant bounds of 95 percent one-sided confidence intervals)
Richmond	0% (0% to 3%)	Effective Upper bound = 3%
Stockton	1% (0% to 6%)	Not enough evidence Lower bound = 0% or upper bound = 5%
Hill	2% (0% to 7%)	Not enough evidence Lower bound = 0% or upper bound = 6%
Norfolk	5% (2% to 12%)	Not enough evidence Lower bound = 2% or upper bound = 11%
Columbus	1% (0% to 6%)	Effective Upper bound = 5%

Source: GAO.

As shown in table 13, we found significant problems with the accuracy of unserviceable condition codes for excess commodities at four of the five DRMOs we tested.

Table 13: DRMO Turn-in Transactions Classified as Unserviceable That Failed Control Tests for Condition Code Accuracy

DRMO tested	Estimated failure rate (95 percent two-sided confidence interval)	Assessment of effectiveness of controls (and relevant bounds of 95 percent one-sided confidence intervals)
Richmond	26% (18% to 36%)	Ineffective Lower bound = 19%
Stockton	10% (5% to 17%)	Ineffective Lower bound = 5%
Hill	6% (2% to 13%)	Not enough evidence Lower bound = 3% or upper bound = 12%
Norfolk	17% (10% to 26%)	Ineffective Lower bound = 11%
Columbus	23% (14% to 34%)	Ineffective Lower bound = 15%

Source: GAO.

As shown in table 14, we found condition codes to be reliable at the five DLA supply depots that we tested.

Table 14: DLA Supply Depot Turn-in Transactions That Failed Overall Control Tests for Condition Code Accuracy

DLA depot tested	Estimated failure rate (95 percent two-sided confidence interval)	Assessment of effectiveness of controls (and relevant bounds of 95 percent one-sided confidence intervals)
Richmond	0% (0% to 2%)	Effective Lower bound = 0% Upper bound = 2%
San Joaquin	0% (0% to 2%)	Effective Lower bound = 0% Upper bound = 2%
Hill	0% (0% to 3%)	Effective Lower bound = 0% or upper bound = 2%
Norfolk	1% (0% to 3%)	Effective Lower bound = 0% or upper bound = 2%
Columbus	0% (0% to 2%)	Effective Lower bound = 0% or upper bound = 2%

Source: GAO.

GAO Contacts and Staff Acknowledgments

GAO Contacts

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Attachment 2

DRMS "At a Glance"

Visit our award-winning Web site! http://www.dla.mil/drms -- or -- http://wex.drms.dla.mil

Originally established in 1972 to consolidate the different military services' disposal operations, the Defense Property Disposal Service (DPDS) was renamed the Defense Reutilization and Marketing Service (DRMS) in 1985. DRMS is part of the Defense Logistics Agency (DLA), based in Fort Belvoir, Va.

Disposing of excess property. DRMS disposes of excess property received from the military services. The inventory changes daily and includes thousands of items: from air conditioners to vehicles, clothing to computers, and much more.

Property is first offered for reutilization within the Department of Defense (DoD), transfer to other federal agencies, or donation to state and local governments and other qualified organizations.

Reutilization means big savings. In fiscal 2003, $1.2 billion worth of property was reutilized. Every dollar's worth of property reutilized is a tax dollar saved. DRMS also supports the Humanitarian Assistance and Foreign Military Sales programs.

Selling DoD surplus property. DRMS manages the DoD surplus property sales program. Excess property that is not reutilized, transferred or donated may be sold to the public as surplus.

The DRMS National Sales Office has a commercial venture partnership with Government Liquidation to purchase and re-sell all non-demil-required usable property in the United States, Guam, Hawaii and Puerto Rico. Sales include high-value property, such as aircraft parts, machine tools, hardware, electronics, material handling equipment, and vehicles. DRMS overseas locations conduct zone sales for all non-demil required usable property. These sales are either held through sealed bid, auction, or retail, fixed price sales, aimed at customers interested in buying inexpensive items for personal use.

DRMS also offers a sales service for those DoD customers who have direct sales authority (such as under the Exchange Sale Program). For a modest percentage of the proceeds, DRMS will perform all merchandizing, advertising and contracting functions, providing the DoD military service peace of mind that all laws and regulations are followed.

Our Web site. DRMS displays property available for reutilization, transfer and donation on the Internet. The Web site offers detailed information, including the property's condition and location. For sales information, sales schedules, and past bid sales results, go to the Government Liquidation Web site, **http://www.govliquidation.com/** .

Keeping the environment in mind. DRMS manages the disposal of hazardous property for DoD activities, maximizing the use of each item and minimizing environmental risks and costs.

Special programs. The Resource Recovery and Recycling Program conserves natural resources, reduces waste products and returns revenue to the military services.

Through recycling, the Precious Metals Recovery Program significantly reduces the need for DoD to purchase metals such as gold, silver and platinum family metals through recycling of excess and surplus scrap containing precious metals.

Demilitarization . Certain property is demilitarized (i.e., rendered useless for its originally intended purpose). Surplus property with inherent military characteristics must undergo "demil." Offensive and defensive weapons and associated material are demilitarized prior to sale or as a condition of sale.

Global support for the U.S. military. DRMS has a worldwide presence within DoD, with disposal specialists in 12 foreign countries, two U.S. territories (Guam and Puerto Rico) and 39 states. The total DRMS work force numbers approximately 1,600 civilians and 14 military personnel. Of those, approximately 340 work at its Battle Creek, Mich., headquarters.

DRMS provides direct support to the U.S. military at 26 sites in 13 nations and 21 time zones. It also supports military contingency missions, wherever that takes us, be it Saudi Arabia, Bosnia, Kosovo or Uzbekistan.

Customer Contact Center:

(877) 352-2255 (from Canada: (269) 961-7197)

Customer service representatives are available to answer your questions 24 hours a day, seven days a week. You can also fax your questions, (269) 961-5305, or e-mail them, **custservice@dlis.dla.mil**

Fiscal 2003 Statistics

Operating obligations $298 million

R/T/D $1.5 billion (original acquisition value)

Reutilized $1.2 billion

Transferred $159.4 million

Donated $188.2 million

Sales $53.1 million

Usable property $31.9 million

Scrap $19.3 million

Foreign Military Sales $1.9 million

Special programs

Resource Recovery and Recycling (Reimbursements to the military services) $4.9 million

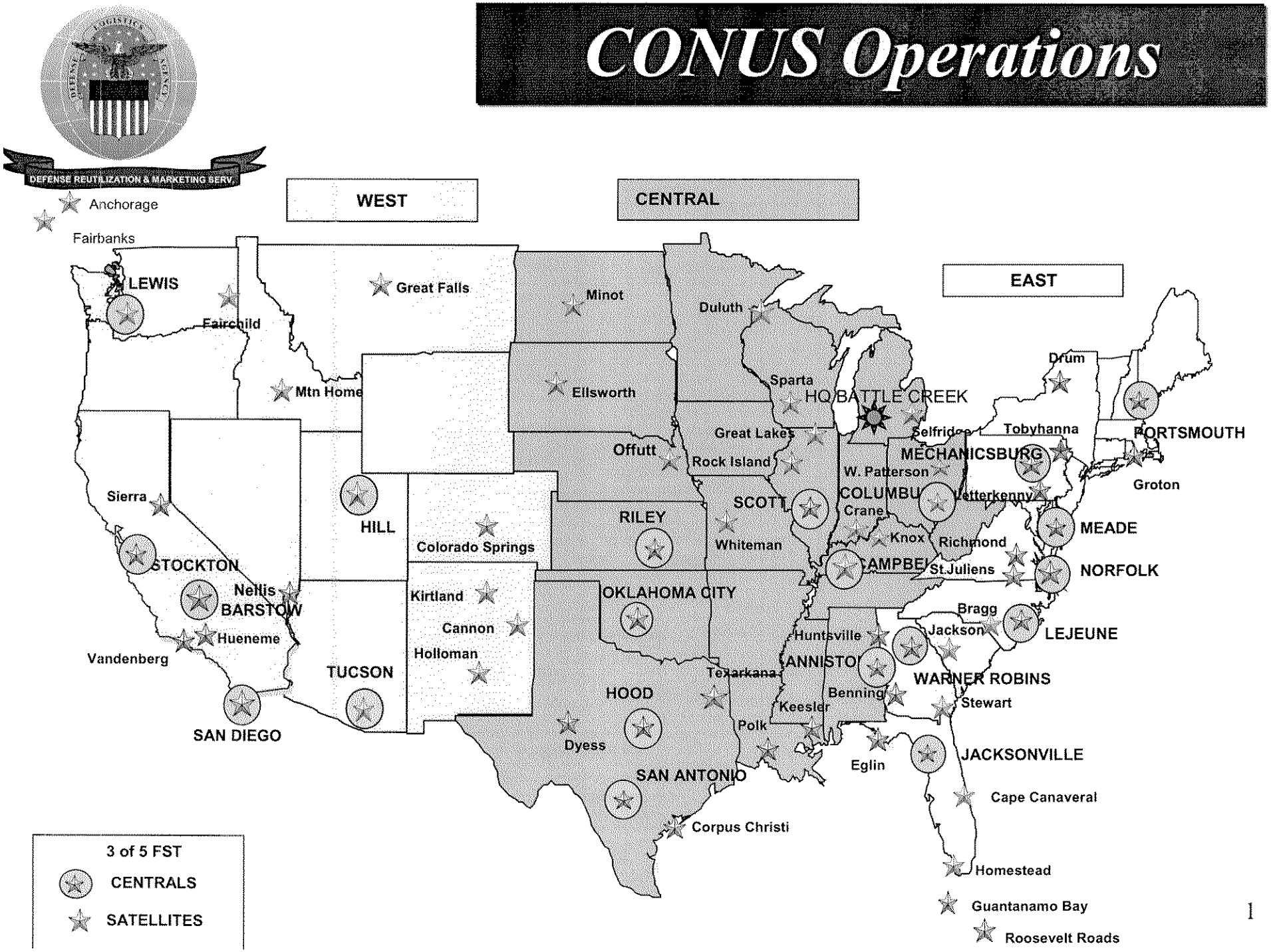
Precious Metals Recovery $2.8 million

Updated March 2004 by the Office of Public Affairs

Last Updated: 3/17/04

Attachment 3

CONUS Operations



Attachment 4

Special Excess Material Disposal Programs

- *Humanitarian Assistance Program (HAP)*: DRMS provides DOD excess property, as coordinated through State Department, consisting of items of a humanitarian assistance nature, and distributed to needy third world countries.

- *Law Enforcement Support Office (LESO)*: DRMS issues DOD excess property to support law enforcement agencies in conducting their daily operations. This is a large customer base with approximately 12,000 state and local agencies currently enrolled.

- *DOD or Service Museums*: DRMS issues DOD excess property for museum use, display, or exchange. Currently, DOD or service museums may acquire items for housekeeping purposes only.

- *Academic Institutions and Nonprofit Organizations for Educational Purposes*: These educational entities may acquire donations of excess research equipment to educational institutions and nonprofit organizations for conducting technical and scientific education and research activities.

- *National Guard Units*: Requests for excess property for National Guard units must have the approval of the National Guard Bureau or their authorized representative.

- *Senior Reserve Officer Training Corps (ROTC) Units*: Senior ROTC units of the military services may obtain excess property from DRMO's to support supplemental proficiency training programs.

- *Morale, Welfare, Recreation Activities (MWRA) Services*: May requisition excess property through their servicing Accountable Officer. Items requisitioned from DRMO are for administrative and other purposes from which no direct benefits will be realized by individuals.

- *Military Affiliate Radio System (MARS)*: MARS operates under the command jurisdiction of the Military Services and is associated with the DOD communication system. The Military Services responsible

for MARS are authorized to requisition excess property through their respective accountable officers.

- *Civil Air Patrol (CAP)*: CAP is the official auxiliary of the USAF and is eligible to receive excess property without reimbursement. Title to the property is transferred to CAP under the condition that the property will be used by CAP to support valid mission requirements. The CAP must return unneeded property to the DRMO.

- *DOD Contractors*: The Military Service/Defense Agency Management Control Activity (MCA) is authorized to withdraw specific excess property from DRMO's for use as Government Furnished Equipment (GFE) to support officially stated contractual requirements.

- *Foreign Military Sales (FMS/Grant Aid)*: DRMS conducts the sale of excess defense articles to foreign governments. Property is issued free and the country pays for packing, crating and handling. DRMS is reimbursed for administration costs only.

Attachment 5

The Exclusive Partner of the U.S. Department of Defense for the Sale of Military Surplus

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Demil BQ Helicopter Housing Assemblies @ Norfolk, VA
BID DATES: May 20 - 25

Internet Auction - 1372
Demil BQ Industrial, Marine & Vehicular
BID DATES: May 23 - 25

Internet Auction - 1373
Norfolk & Richmond, VA / Huntsville, AL
BID DATES: May 24 - 26

Internet Auction - 1477
Outboard Motors & Marine Equipment @ Jacksonville, FL
BID DATES: May 24 - 26

Internet Auction - 1516
Desktop & Laptop Computers @ Norfolk, VA
BID DATES: May 24 - 26

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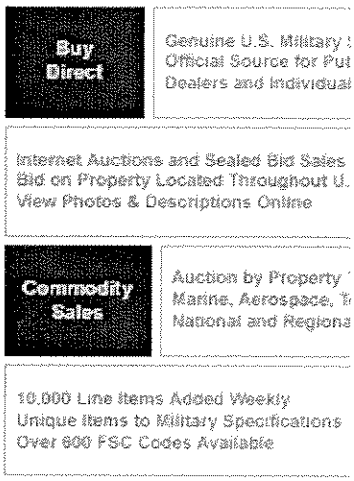
About Government Liquidation, LLC and Liquidity Services, Inc.

Government Liquidation, LLC (GL), a subsidiary of Liquidity Services, Inc. is the exclusive partner of the U.S. Department of Defense for the sale of surplus property.

GL operates an innovative and powerful online sales channel that enables surplus buyers to purchase available government assets in a convenient and open environment. GL utilizes world- class logistics, technology, marketing and customer service capabilities to assemble and promotes available property for the convenience of its buyers. GL's dedicated team of professionals manage over 2 million square feet of warehouse space and maintain outposts on over 150 military bases throughout the continental U.S., Alaska, Hawaii, Puerto Rico and Guam.



GL is part of a critical mission to keep surplus and idle inventories moving out of defens maximizing efficiencies, while creating a valuable cash flow source to the U.S. Treasury. Liquidation LLC. is the leading global seller of assets in over 600 different U.S. Governm commodity categories, including:

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- Industrial Machinery & Equipment
- Medical, Dental & Laboratory Equipment
- Military Apparel & Accessories
- Passenger & Military Vehicles
- Boats & Marine Support Equipment
- Building & Construction Materials

Corporate Overview

Headquartered in Washington D.C., Liquidity Services, Inc leading global provider of full service solutions to sell bulk assets. Liquidity Services, Inc. has combined its in-depth r knowledge, superior technology and operational expertise major manufacturers, distributors, retailers, service compa public sector agencies with a complete solution to convert assets into cash quickly and conveniently.

Liquidity Services, Inc. utilizes online marketplaces, business-to-business prod and marketing expertise, and value-added services to complete 14,000 bulk s transactions monthly. Our network of buyers and sellers source and sell bulk i

wide range of categories, including consumer merchandise, transportation, ele
audio/video equipment, computers, industrial equipment, construction materia
supplies, medical equipment and aircraft parts.

Attachment 6

The Demilitarization Program

The command's mission is to provide worldwide management and disposition of the vast and growing array of material no longer needed by the military services. Types of material handled by DRMS run the gamut from baby bottles to battleships.

DRMS disposes of excess property received from the military services. Some of this property was built strictly for military purposes and was never meant to be a part of the everyday life of our communities. This type of property must be rendered useless for its intended purpose prior to sale or removal from government property. Demilitarization is the process used to do so. Recently revised "demil" procedures not only ensure compliance with regulations, but also encourage DRMS employees to challenge obsolete or ineffective requirements.

The demilitarization program is a major part of the DRMS mission. It prevents offensive and defensive military equipment from being released to the public. It also prevents battlefield-related property from being unnecessarily rendered useless. For instance, tanks and rocket launchers are candidates for sale as scrap after demilitarization; tents and combat boots can be reused or sold to the public.

Demilitarization codes and the supply chain

As property is acquired by the Department of Defense (DoD), one of the military services or a defense agency assigns a demilitarization code to the material, based on specific DoD-wide policy. Most items that enter the supply system receive a "no demilitarization required" code, such office furniture, tools or appliances. On the other hand, items such as arms or munitions must be rendered useless prior to sale, and receive codes that require things like burning, shredding or pulping. The demilitarization codes have recently been modified to enhance the effectiveness of the program.

DRMS is the final link in the DoD supply chain. Excess DoD property is turned in for disposal at 98 DRMS field offices worldwide, called Defense Reutilization and Marketing Offices (DRMOs). The property is stored separately from other material. Our employees review the demilitarization codes for accuracy. An audit trail is established for the property, including verification that demilitarization is accomplished. Inappropriate management of this property has the potential of compromising national security or U.S. foreign policy; unnecessary demilitarization can prevent the reuse or sale of valuable property.

The DRMS "Demil Challenge Program"

Whenever a DoD activity turns in an excess item at one of our DRMOs, our technical specialists verify the accuracy of the demilitarization code. If the code is thought to be inaccurate, it is "challenged." A written report concerning the potential coding error is forwarded to DRMS headquarters. Extensive research is conducted. If the code is found to be in error, the code will be changed for all like items entering the supply system.

The challenge program is a quality control measure that continually enhances the demilitarization effort. Our employee's concerns are taken seriously, researched and acted on if necessary.

Reutilization, transfer and donation

Many items that once were purchased to support combat readiness can be reused. Property is first offered for reutilization within the DoD, transfer to other federal agencies, or donation to state or local governments and other qualified organizations. For instance, through the General Services Administration's donation program, DRMS has been able to offer local and state police department's equipment that can be used for law enforcement. In many cases, partially demilitarized property can be reused without endangering the public. Property is also provided for the State Department's Foreign Military Sales Program.

Updated: April 2001

Attachment 7

Excess Property Condition Codes

DOD's condition code is a two-digit alphanumeric code used to denote the condition of excess property from the supply and the disposal perspective. The DOD supply condition code is the alpha character in the first position and shows the condition of property in the DLA depot inventory, or is assigned by the unit turning in the excess property. The GSA disposal condition code, in the second position, shows whether the property is in new, used, or repairable condition, salvageable, or should be scrapped. (See table 7.)

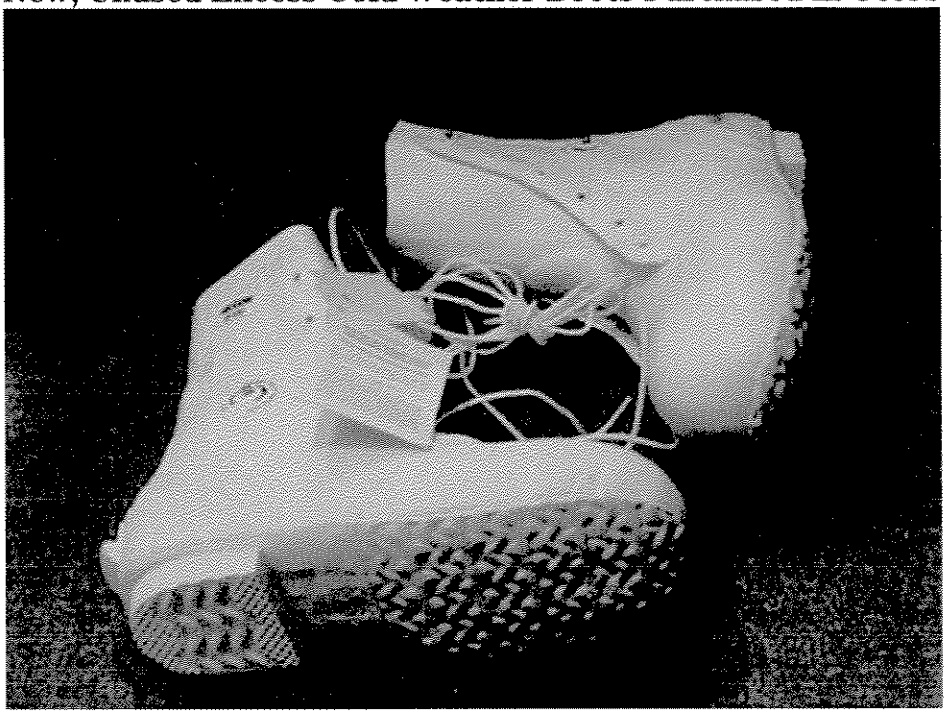
DOD Excess Property Condition Codes

DOD codes	DOD supply condition code	GSA disposal condition code
	Serviceable property	
A1, A4	**A – Issuable without qualification** – New, used, repaired or reconditioned property that is issuable without restriction, including material with a shelf life of more than 6 months.	**1 – Excellent** – Property is in new or unused condition and can be used immediately without repairs.
B1, B4	**B - Issuable with qualification** – New, used, repaired, or reconditioned property that is issuable, but is restricted from issue to specific units, activities, or geographical areas by reason of its limited usefulness or short service life expectancy, including materials with a shelf life of 3 through 6 months.	**4 – Usable** – Property shows some wear, but can be used without significant repair.
C1, C4	**C - Priority issue** – Property is issuable to selected customers but must be issued before Condition A and B material to avoid loss as a usable asset, including materials with less than 3-months' shelf life.	**7 – Repairable** – Property is unusable in its current condition, but can be economically repaired.
D1, D4, D7	**D - Test/Modification required** – Property is in serviceable condition but requires test, alteration, modification, or conversion or disassembly.	
	Unserviceable property	
E7	**E - Limited restoration required** – Property requires only a limited expense or effort to restore to serviceable condition.	**7 – Repairable** – Property is unusable in its current condition, but can be economically repaired.
F7	**F – Reparable** – Property is economically reparable but requires repairs, overhaul, or reconditioning to make it serviceable property.	
G7	**G – Incomplete** – Property requires additional parts or materials to complete the item prior to issue.	
H7	**H - Condemned** – Property has been determined to be unserviceable and does not meet repair criteria, including items whose shelf life has expired and cannot be extended.	
FX, GX, HX (VX- Salvaged military munitions)	**Salvage property** **F – Reparable; G – Incomplete; H – Condemned**	**X - Salvage** – Property has value in excess of its basic materiel content, but repair is impractical and/or uneconomical.
FS, GS, HS	**Scrap property** **F – Reparable; G – Incomplete; H – Condemned**	**S - Scrap** – Property has no value except for its basic materiel content.

Source: DAISY C-A-T (Codes and Terms) reference guide (11th ed. 2003) and DRMS-I 4160.14, vol. IV, Supp. 1, "Codes Index" (November 2004).

Attachment 8

New, Unused Excess Cold Weather Boots Purchased in October 2004.



Source: *Govliquidation.com.*

Attachment 9

Figure 7: One of the New, Unused Excess DOD Circuit Cards Transferred to GAO in September 2004

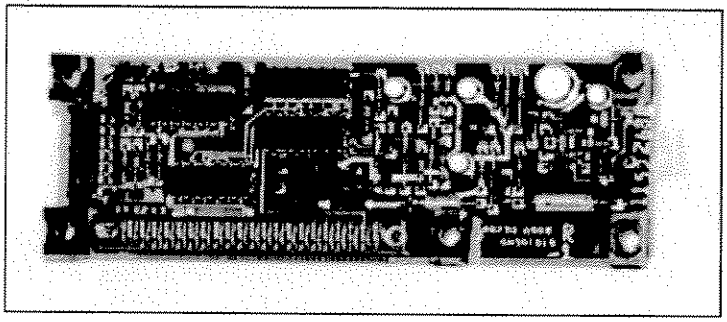


Figure 8: New, Unused DOD Power Supply Unit Requisitioned by GAO in September 2004 from the DLA Depot in Norfolk, Virginia